

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 02 GUATEMALA 000525

SIPDIS

WHA FOR DAS FISK AND DAS DERHAM
EB FOR DAS GREENWOOD
TREASURY FOR OASIA: BILL BLOCK

E.O. 12958: DECL: 02/02/2009

TAGS: [EFIN](#) [PGOV](#) [GT](#)

SUBJECT: EMBASSY SUPPORTS GUATEMALAN REQUEST FOR QUICK
DISBURSEMENT OF IDB SAL FUNDS

Classified By: Ambassador John R. Hamilton for reason 1.5 (d)

Summary and Action Request

1. (C) Guatemala's new government is strapped for cash. It inherited a backlog of unpaid bills and lost 10% of its tax base to a court challenge. It is proposing serious fiscal reform, including cutting the military by half and attacking the corruption that depletes or diverts revenues, but its longer-term plans will rely on resuscitating the Fiscal Pact so that it has the mandate and legitimacy to force enduring reform, including any tax increases, through a fractious Congress. It is choosing not to borrow or negotiate with the IMF in the absence of Fiscal Pact legitimacy, and that leaves few short-term options other than crippling austerity. To survive though the short term without abandoning all initiative, the GOG will shortly be asking for the release of \$80 million in IDB sector adjustment loan resources. We understand that they have the sympathy of the Fund and IDB, but they are not fully in compliance with the Fund program. We urge Washington agencies to support release of the \$80 million to help underwrite the new government's extraordinarily promising start.

2. (C) We have just heard that Guatemala may request an additional \$50 million of World Bank sector adjustment funding. Our understanding is that those funds are not intended for budget support but instead for recapitalization of the banking system. We would want to know more about compliance with the Bank's program and the mechanics of disbursement before recommending any action on this request. End Summary and Action Request.

Bleak Short Term Outlook While Fiscal Pact Resuscitated

3. (SBU) Guatemala is strapped for cash. The Berger administration came to office with empty coffers, backlogs of unpaid salaries and bills, and on the heels of a court ruling that eliminated the "IEMA" asset-based tax that had provided ten percent of total revenues. Tax reform is necessary and will be a Berger priority. The Berger administration proposes to begin the process by resuscitating the Fiscal Pact that was negotiated by the Arzu Administration in 1999, after the Peace Accords, with some 650 civil society groups. The Portillo government subsequently discarded the Pact. The new administration calculates that a renewed Fiscal Pact will provide the mandate and legitimacy needed to push a 2004 budget and tax reform plan through an unfocused and politicized Congress. Until that happens, the government is choosing not to approach international debt markets or negotiate a new program with the IMF in order not to be seen as prejudicing the outcome of the Fiscal Pact discussions. This leaves the government dependent upon austerity measures and a depleted tax base until the new Fiscal Pact can be agreed and implemented.

\$80 Million from the BID Requires Flexibility

4. (C) In the interim, \$80 million of fast-disbursing funds are potentially available from the IDB under the Financial Sector Adjustment program. Disbursement is contingent, however, upon IMF concurrence or compliance with an IMF program. Guatemala currently is not fully compliant with its IMF stand-by, and we understand that it is for two reasons that are relatively minor: 1) a law exempting the sale of bank asset portfolios from the value added tax is still stuck in Congress, and 2) outside auditors have not been brought in to look into the failed national mortgage bank (CHN). The tax exemption is not particularly controversial, and we expect it will be passed in due course. The CHN audit has been overcome by events, as the bank's failure is no longer just a bankruptcy but the centerpiece of high-profile criminal cases under investigation by Guatemalan prosecutors and the U.S. BICE. The IMF stand-by agreement will likely lapse in mid-March without Guatemala's full compliance, and the government does not expect to seek another Fund program until later in the year.

Fund and IDB Staffs Look to the USG

5. (C) We understand that both the IMF and IDB staffs are

prepared to be flexible if their boards are prepared to concur. We also hear that the staffs will be looking specifically to the U.S. executive directors for signs of our sentiments. This filtered back to us following IDB President Iglesias's trip here a couple of weeks ago. We note that it was the U.S., with this Embassy's strong urging, that abstained on the 2002 stand-by agreement because supposed prior conditions on financial reform legislation had not been fully met. We heard at the time that it wasn't a pleasant experience for Fund staff, and we're not surprised at their caution this time. Times have changed, however. In 2002 we were concerned about giving the benefit of the doubt to a government that had veered seriously off course. This time, we have a government that knows where it's going and whose aims we support.

Economic Team to Visit Washington

16. (C) A vice ministerial delegation from the Berger economic team arrived in Washington over the February 28-29 weekend to seek concurrence of the Fund and Treasury to release the \$80 million from the IDB. We had been told that economic policy coordinator Aitkenhead and Finance Minister Bonilla would lead a team later in the week, but Aitkenhead changed his mind and dispatched a more junior mission in order to save time. We believe strongly that we should accommodate the Guatemalan request. The new government has, in six weeks, brought extraordinary pressure to bear on corrupt former officials (both the former President and his revenues chief abruptly left the country before court orders barring their travel took effect), and it has convoked the renewed fiscal pact dialogue and chosen its moderators. It has changed management in the ports, where customs and tax evasion were largely centered, and is working on a plan to cut the military by half. The early signals could not be more clear that the Berger Administration wants its fiscal house in order, with efficient revenue collection and refocused spending on education and health. It has also made clear that it is prepared to raise tax rates if needed to finance what Guatemalans want from their Fiscal Pact, but that will take some time. The quickest and most tangible action we can take in coming days to help the government keep its momentum would be help it access the IDB disbursement.

World Bank Funds

17. (C) The Guatemalans may also ask for disbursement of approximately \$50 million in World Bank sector adjustment funds. We are not yet ready to recommend how to deal with such a request and would want to consult further with our World Bank colleagues on Guatemala's compliance with some of the specific conditionalities in their program. The World Bank program undewrites, at least in part, a specific mechanism of subordinated debt to help recapitalize the banking system and is not simply policy-linked budget support. Our initial reaction is that the World Bank funds are a crucial element in bank restructuring efforts spanning several years and are best left for their intended purpose.

HAMILTON